AfDB

Development Research Brief

Number 8 | August 2009

EDRE Development Research Department
Office of the Chief Economist, ECON

The G20 in Africa: Issues and Concerns

Tonia Kandiero*

Introduction

The global economy is experiencing immense contraction in output. There is also a substantial rise in unemployment in key sectors that depend on global demand. Mining is one of them. In Africa, job cuts in the mining sector are pervasive. De Beers has already lost 4,500 jobs in Botswana. Similar numbers of job losses have been reported in the Democratic Republic of Congo (DRC) and in Zambia's copper mines. For Africa, this is, therefore, not a temporary crisis requiring temporary solutions. It will take sustained concerted efforts to return countries on the continent to the previous growth trajectory. African countries need to identify key economic activities in distress — those that threaten unemployment, growth, and poverty reduction.

The African Development Bank (AfDB) welcomes recent commitments by the G20 to find solutions to mitigate the impact of the financial crisis and to revive the global economy. Going forward, how can African countries benefit from the goodwill of the G20 countries? To answer this question, this note focuses on three identified stress areas: (1) Access to financing; (2) supporting trade; and (3) the importance of dialogue on regulation and other global governance issues.

Access to financing is getting more difficult

A key challenge to Africa's growth prospects concerns access to secure, adequate, and stable external private and public financing. The financial crisis has led to significantly reduced enthusiasm by private investors to channel funds to African markets and projects. This is amplified by tendencies towards "capital protectionism". In countries where capital accounts are liberalised, large amounts have been divested from the stock exchanges. In Nigeria, for example, international hedge fund managers have divested as much as USD10 billion out of the country in a short time, while credit lines have shrunk rapidly. Fundraising for new initiatives such as the Nigeria Infrastructure Fund are in jeopardy.

Further, prior to the crisis, Africa was enjoying rising flows of Foreign Direct Investment (FDI), reaching USD35 billion in 2007. FDI inflows were projected to exceed USD54 billion in 2008, but these may not have materialised due to risk aversion by investors. Egypt has already revised expected FDI inflows for 2009 from USD13 billion to USD10 billion. Other countries are likely to experience similar trends.

The global economic crisis will make it more difficult for donors to deliver on recent "waves" of commitments to increase aid to Africa. The Gleneagles G8 summit commitments to double ODA (official development assistance) to Africa by 2010 are unlikely to be realised.

In real terms, ODA rose to record levels by 10.2 percent to USD120 billion in 2008, representing a 0.30 percent of OECD Gross National Income (GNI). However, according to the OECD's Development Assistance Committee (DAC), the levels represent a 58-percent shortfall of aid to Africa with respect to the Gleneagles G8 commitment to scale up development assistance by 2010. Further, the contraction of economic activities in developed countries as a result of the financial crisis will lead to a decline in value of assistance as a share of GNI.

Similarly, remittances from the continent's Diaspora may fall as incomes become uncertain. Estimated at USD27.8 billion in 2007, remittances were poised to increasingly become an important source of private external financing for development in Africa. These prospects have been jeopardised by the global economic crisis. While remittances are expected to decline in 2009, the good news is that they will rebound in 2010 with the economic recovery.

The AfDB estimates that sustaining Africa's pre-crisis growth levels would require an additional USD50 billion in 2009 and USD56 billion in 2010. Increasing investment to the level needed to achieve growth rates that are consistent with the Millennium Development Goals would require an additional USD117 billion in 2009 and USD130 billion in 2010. There is, therefore, an urgent need to address the financing situation. G20 commitments constitute an important step forward.

Supporting Trade Remains a Challenge

The sharp worldwide economic downturn has led to an immense contraction in global trade. Growth in African export volumes is expected to decrease to 3.6 percent in 2009 from a buoyant rate of 10.6 percent in 2008. This translates to a loss in export value of 45.4 percent (AfDB and UN estimates). In Uganda, the second leading coffee grower after Ethiopia, robusta coffee exports were 34 percent lower in March 2009 than in the previous year (USD 23.9 million compared to USD 36.3 million). As a result of declining trade flows, taxes associated with trade will fall dramatically in Africa. In 2009, the continent will suffer a shortfall in trade tax to the tune of USD 15 billion.

The shortage of liquidity in the financial markets has also translated into a lack of credit for trade finance. According to the World Trade Organisation (WTO), 60 percent of trade finance is handled by private agents and 90 percent of the USD 14 trillion worth of global trade is financed by trade credits. Therefore, further tightening of markets has dire consequences on trade performance. WTO estimates that liquidity shortage and disproportionate aversion to risk have caused a shortfall in available trade finance to the order of USD 25 billion, disrupting trade and growth performance and, possibly, exacerbating the effects of the crisis.

It is clear that solutions to boost trade must entail intervention beyond national boarders if they are to be effective and sustainable. This calls for international coordination. In this regard, the G20 can support African countries by ensuring that developed countries refrain from protectionism in responding to the crisis. They should adopt approaches that are inclusive, given the contagious nature of the problem. It is also critical that the G20 makes a firm commitment to conclude the Doha Development Round and to support the Aid for Trade initiative. Aid for trade is essential as a complement to the liberalisation agenda by addressing supply-side constraints, such as transport bottlenecks and related infrastructure, among others.

African countries must also recognise that the goodwill of the G20 can only go so far. The onus is on them to craft short-term and long-term strategies that boost trade as a tool for driving the development agenda. This includes pursuing domestic trade policy reforms that support international rules (simplification, harmonisation and standardisation of rules, procedures and processes), unlocking opportunities in the regional agenda, and increasing participation in the Doha Development Round.

Dialogue on Regulation and other Global Governance Issues

As international financial markets have become more complex, so has the regulatory system overseeing them. There are significantly increasing roles of new funds such as insurances, hedge funds, mortgages, investment banks, commercial banks, and stock exchanges. The mandates of key players, the International Monetary Fund, the World Bank, and to a lesser extent, regional development banks, are currently being re-examined in a bid to adapt them to changing development financing needs and current realities.

While the current crisis poses serious challenges to the global economy, it also presents an opportunity that needs to be harnessed at both the global and national levels. At the global level, the crisis provides a platform for taking a hard look at the structure and governance of the global financial system to enhance its stability and resilience to shocks. Reforms at this level should aim at ensuring transparency in financial transactions, the strengthening of regulation and supervision of financial institutions and the establishment of better mechanisms for surveillance and crisis prevention. At the national level, reforms should focus on building a regulatory infrastructure that promotes sound banking institutions, encourages saving and lending, especially long-term financing, and fosters responsible financial innovations – those that preserve transparency and accountability to ensure financial system stability. Achieving financial stability at the global, regional and national levels will require more systematic coordination of efforts across all these levels.

For Africa to fully benefit from reforms at the global level, it is imperative that it gets engaged and involved in the reform process. In that respect, Africa should advocate the creation of formal channels to increase its voice and representation in global financial regulation. Particular areas of focus in the pursuit of this goal include:

a) Ensuring greater and effective representation and participation in bodies that design the rules and regulations of the international financial system;
b) Ensuring greater transparency in the enforcement of internationally agreed accounting standards and credit insurance market standards;
c) Increasing participation in the application of global standards of regulation;
d) Encouraging sound banking practices, especially to protect banking sectors against speculative bubbles;
e) Strengthening cross-border supervision and crisis management;
f) Creating an early warning system to address the continent's vulnerability to shocks.

The key message in this section is that there is shared interest by the financial community and development partners in restoring global financial stability and restoring values as well as confidence in financial markets. Credibility through sound regulation and improvement in the financial system governance structures is the way forward.

Conclusion

In Africa, the global financial crisis has indeed turned into an economic and development crisis. It threatens to reverse hard won gains from reforms over the past decade in much of the continent. Unlike advanced economies, Africa simply does not have adequate resources to mitigate the effects of the crisis through fiscal stimulus. The crisis has had severe implications on the financing of major development programmes as well as recurrent expenditures. It coincides with the food price crisis, and comes at a time when Africa is feeling the effects of climate change which, unfortunately, is not of its own making. Most importantly, there is a danger that the financial crisis will impact on longer-term development and undermine progress on poverty reduction and other Millennium Development Goals, as planned expenditures have to be delayed or even cancelled. It will put investment in infrastructure at risk, yet such investment is fundamental for private sector-led growth. Therefore, as much as G20 commitments are important, they constitute only one step in the longer process of reforms in the international system. It is clear that Africa needs to have a stronger voice in the debate on strategies to mitigate the impact of the global financial crisis. The continent's representation at the G20 meeting in London was an important step in the right direction.

Africa in the G20

G20 Commitments at a Glance

FINANCIAL REGULATION
• A new financial stability board, with a strengthened mandate, will replace the financial stability forum
• Financial regulation and oversight will be extended to all financial institutions, instruments and markets
• This includes bringing hedge funds within the global regulatory net for the first time
• Members are committed to implementing tough new rules on pay and bonuses at a global level
• International accounting standards will be set
• Credit rating agencies will be regulated in order to remove their conflicts of interest
• A common approach to cleaning up banks' toxic assets has been agreed
TAX HAVENS
• There will be sanctions against tax havens that do not provide information on request
• The Organization for Economic Co-operation and Development has published a list of countries assessed by the Global Forum against the international standard for exchange of tax information
INTERNATIONAL MONETARY FUND
• Resources available to the International Monetary Fund will be tripled to US$750bn
• This includes a new overdraft facility, or special drawing rights allocation, of US$250bn
• Additional resources of US$6bn from agreed IMF gold sales will be made available for lending to the poorest countries
• The G20 also supports increased lending to the world's poorest countries of at least US$100bn by multilateral development banks
GLOBAL TRADE
• There will be a commitment of US$250bn of support for trade finance made over the next two years
• This will be made available through export credit and investment agencies, as well as through multilateral development banks
• National regulators will be asked to make use of available flexibility in capital requirements for trade finance
PROTECTIONISM
• The G20 has pledged to resist protectionism
• There will be a commitment to naming and shaming countries that breach free trade rules
• The G20 will notify the World Trade Organization (WTO) of any measures that constrain worldwide capital flows
• The G20 has called on the WTO to monitor and report publicly on these undertakings on a quarterly basis
FISCAL STIMULUS
• The G20 countries are already implementing "the biggest macroeconomic stimulus the world has ever seen" according to Prime Minister Gordon Brown - an injection of US$5tn by the end of next year

Comments and suggestions can be sent to:

Leonce Ndikumana
Abdul B. Kamara

Development Research Department
African Development Bank

BP 323, 1002 Tunis Belvedere, Tunisia – Tel.: +216 71 102 876 – Fax: +216 71 103 779 – E-mail: economic-research@afdb.org – Web: www.afdb.org

*Tonia Kandiero is a Principal Research Economist in the Development Research Department of African Development Bank.